

Message Text

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FM AMEMBASSY WARSAW

TO SECSTATE WASHDC 3671

C O N F I D E N T I A L SECTION 1 OF 2 WARSAW 6251

E.O. 11652: GDS

TAGS: EFIN EWWT PL

SUBJ: POLISH DEBT

REF: (A) STATE 209123, (B) WARSAW 1563

1. SUMMARY: SERVICING POLAND'S LARGE AND GROWING DEBT IN THE COMING MONTHS WILL BE INCREASINGLY DIFFICULT. NEVERTHELESS, THE GOP HAS QUITE A BIT OF ROOM FOR MANEUVER BEFORE IT MIGHT FEEL REQUIRED TO SEEK RESCHEDULING OF ITS DEBT AND WOULD PROBABLY RESCHEDULE ONLY AFTER ALL OTHER POSSIBILITIES HAD BEEN EXHAUSTED. UNLESS POLAND CAN SUBSTANTIALLY INCREASE ITS HARD-CURRENCY EXPORTS IN THE INTERVENING MONTHS, RESCHEDULING MIGHT HAVE TO BE CONSIDERED IN MID OR LATE 1977. THERE WOULD APPEAR TO BE ALMOST NO CHANCE OF AN OUTRIGHT DEFAULT UNLESS THERE WERE A GRAVE DETERIORATION IN EAST-WEST RELATIONS. END SUMMARY.

2. POLAND'S HARD-CURRENCY DEBT, WHICH WAS ESTIMATED AT \$7.5 BILLION AT THE END OF 1975, HAS PROBABLY GROWN BY WELL OVER ONE BILLION DURING THE FIRST HALF OF 1976. POLAND'S CONVERTIBLE-CURRENCY TRADE DEFICIT TOTALLED OVER ONE BILLION DOLLARS IN THAT PERIOD AND MANY OF THE NEW CREDITS SECURED IN RECENT MONTHS WERE USED MAINLY TO PAY THE INTEREST AND NOT THE PRINCIPAL PORTIONS OF EXISTING DEBTS. THEREFORE, POLAND NOW PROBABLY OWES IN THE NEIGHBORHOOD OF \$9.0 BILLION. WE CAN BE EVEN LESS PRECISE ABOUT ITS DEBT-SERVICE REQUIREMENTS, BUT WE WOULD ESTIMATE THAT FOR CALENDAR YEAR 1977 THEY WILL BE ABOUT \$2.0 BILLION.

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3. THE RECENT DEBACLE OF THE JUNE 25 ATTEMPT TO RAISE PRICES HAS

NOT HELPED POLAND'S STANDING WITH WESTERN BANKERS. THOSE BANKERS PREFER THAT THE COUNTRIES TO WHICH THEY LEND -- WHETHER CAPITALIST OR COMMUNIST -- NOT BE CONCERNED ABOUT RESTIVE POPULATIONS. SPONTANEOUS OUTBREAKS AGAINST EITHER CAPITALIST OR COMMUNIST GOVERNMENTS ARE NOT LOOKED ON AS CONDUCIVE TO STABLE ECONOMIES. NEVERTHELESS, WESTERN COMMERCIAL BANKS AND EXPORT-FINANCING AGENCIES STILL SEEM EAGER TO FINANCE ALL OF POLAND'S CAPITAL-EQUIPMENT NEEDS AND SIZEABLE IMPORTS OF CONSUMABLES SUCH AS STEEL AND FOODSTUFFS.

4. THE MAJOR IMPACT OF THE JUNE 25 EVENTS ON WESTERN BANKERS SEEMS TO HAVE BEEN TO STRENGTHEN THEIR ALREADY GREAT RELUCTANCE TO PROVIDE FINANCIAL CREDITS TO POLAND. AS WE EMPHASIZED IN WARSAW'S 1563, POLAND'S MAJOR FINANCIAL PROBLEM IS GAINING THE TIME IT NEEDS TO INCREASE HARD-CURRENCY EXPORT EARNINGS ENOUGH TO PAY FOR NON-FINANCED IMPORTS FROM THE WEST AND MEET ITS HEAVY DEBT SERVICING REQUIREMENTS. TO GAIN THIS TIME, IT BADLY NEEDS LARGE AMOUNTS OF FINANCIAL CREDITS WHICH CAN BE USED TO PAY THE INTEREST AND PRINCIPAL ON EXISTING LOANS.

5. AS WESTERN BANKS HAVE BECOME INCREASINGLY UNWILLING TO PROVIDE FINANCIAL CREDITS, THE POLES HAVE REQUIRED GROUPS EAGER TO MAKE LARGE EQUIPMENT SALES TO PROVIDE 20 PERCENT OR MORE OF FINANCIAL CREDITS ON TOP OF THE SUPPLIER-CREDIT PORTION OF THEIR OFFERS. THIS TECHNIQUE EXTRACTED \$100 MILLION OF FINANCIAL CREDITS FROM THE BRITISH GROUP WHICH WON THE CONTRACT FOR THE PVC PLANT AT WLOCLAWEKIE AND \$150 MILLION FROM THE FRENCH GROUP WHICH WON THE FERTILIZER-PLANT CONTRACT AT POLICE. THE KOPPERS-KRUPP GROUP WHICH WAS AWARDED A LARGE COAL-GASIFICATION CONTRACT DURING GIEREK'S JUNE VISIT TO THE FRG PROVIDED ABOUT \$250 MILLION OF FINANCIAL CREDITS AS PART OF THE DEAL.

6. IN THE STILL-TO-BE-CONCLUDED GM DEAL, POLAND HAS ASKED FOR \$200 MILLION IN FINANCIAL CREDITS, BUT APPEARS READY TO SETTLE FOR A MINIMUM OF \$100 MILLION. THE ACTUAL AMOUNT WILL BE DETERMINED BY THE SUCCESS THAT GM AND ITS LEAD BANK, MORGAN GUARANTY, HAVE IN ATTRACTING WESTERN BANKS TO PARTICIPATE IN THE FINANCIAL PACKAGE. CURRENT INDICATIONS ARE THAT, IF APPROVED, THE GM DEAL SHOULD CONTAIN AROUND \$150 MILLION OF FINANCIAL CREDITS.

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7. WESTERN BANKS, WHICH ARE UNWILLING TO GIVE POLAND FINANCIAL CREDITS DIRECTLY, STILL SEEM EAGER TO DO SO IF IT WOULD GAIN THEM FAVOR WITH A MAJOR WESTERN CLIENT WHICH WANTS TO DO A DEAL IN POLAND. IT IS UNCERTAIN HOW LONG POLAND WILL BE ABLE TO EXPLOIT THIS ATTITUDE OF WESTERN BANKS, BUT ALMOST ALL BANKS WHICH HAVE TOLD THE EMBASSY THAT THEY HAVE REACHED THEIR LENDING LIMIT IN POLAND HAVE SAID THEY WOULD STILL LEND HERE TO SUPPORT A MAJOR WESTERN CLIENT OR POTENTIAL CLIENT. THE PRINCIPAL

CONSTRAINT WE SEE ON THE USE OF THIS TECHNIQUE TO ACQUIRE MORE FINANCIAL CREDITS IS THAT POLAND DOESN'T HAVE TOO MANY MORE MAJOR NEW PROJECTS WITH LARGE WESTERN CORPORATIONS UNDER DEVELOPMENT.

8. THIS IS ESPECIALLY TRUE SINCE POLAND HAS INTENSIFIED ITS VETTING OF NEW INVESTMENT PROJECTS, ESPECIALLY THOSE INVOLVING FOREIGN FINANCING, AND IS SIDETRACKING THOSE WHICH SHOW A NET DOLLAR OUTFLOW AT ANY STAGE OF THE PROJECT.

9. AS THEY HAVE WATCHED THEIR CREDIT STANDING IN THE WEST DETERIORATE, POLISH AUTHORITIES HAVE COME TO REALIZE THAT THEY WILL HAVE TO REACH A POSITIVE HARD-CURRENCY TRADE BALANCE LONG BEFORE THE 1979 TARGET DATE OF WHICH THEY USED TO SPEAK. ALTHOUGH NO SUCH CAMPAIGN HAS BEEN ANNOUNCED, A MAJOR EFFORT IS UNDERWAY TO REDUCE IMPORTS AND TO SQUEEZE AS MANY EXPORTS AS POSSIBLE OUT OF THE ECONOMY. SUCH A CAMPAIGN WILL NOT PRODUCE SIGNIFICANT RESULTS EASILY, AND ITS POLITICAL COSTS MAY BE HIGH. IT IS CLEAR AS WELL THAT MAJOR TRADE-BALANCE IMPROVEMENTS HAVE TO COME FROM THE EXPORT SIDE OF THE LEDGER.

10. THERE IS LITTLE IDENTIFIABLE FAT IN THE STRUCTURE OF POLISH IMPORTS WHICH COULD BE CUT AWAY WITHOUT SIGNIFICANTLY AFFECTING POLAND'S GOALS OF ECONOMIC GROWTH AND THE IMPROVED WELL-BEING OF POLISH CONSUMERS. POLAND CONTINUES TO SEE HIGH-TECHNOLOGY IMPORTS FROM THE WEST AS ESSENTIAL TO ITS ECONOMIC-GROWTH OBJECTIVES, AND THE LARGE PROJECTS BEGUN TO DATE UNDER FOREIGN-COOPERATION AGREEMENTS WILL REQUIRE RELATIVELY CONSTANT LEVELS OF COMPONENT AND RAW-MATERIAL IMPORTS. POLAND'S CONTINUING NEED TO IMPORT LARGE AMOUNTS OF GRAIN (OVER FIVE MILLION TONS IN 1977, AS ESTIMATED BY THE POLISH GOVERNMENT) FURTHER LIMITS ITS FLEXIBILITY TO CUT BACK ON IMPORTS. IN FACT, POLAND IS PROJECTING ABOUT A 10 PERCENT INCREASE IN IMPORTS FOR 1976. IF EXPORTS DO
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NOT ACCELERATE AS HOPED, HOWEVER, TOUGHER MEASURES TO DAMPEN IMPORT GROWTH WILL HAVE TO BE CONSIDERED. THIS WOULD HAVE TO BE DONE WITH THE AWARENESS THAT CONSUMPTION AND GROWTH LEVELS WOULD SUFFER. REDUCING THE SIZEABLE CAPITAL-GOODS SHARE OF HARD-CURRENCY IMPORTS WOULD HAVE RELATIVELY LITTLE FAVORABLE IMPACT ON POLAND'S DEBT-SERVICING PROBLEM. VIRTUALLY ALL CAPITAL-GOODS IMPORTS ARE FINANCED WITH SUPPLIERS' CREDITS, OFTEN INCLUDING A TWO-YEAR GRACE PERIOD.
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FM AMEMBASSY WARSAW

TO SECSTATE WASHDC 3672

C O N F I D E N T I A L SECTION 2 OF 2 WARSAW 6251

11. EVIDENCE THAT A MAJOR CAMPAIGN IS UNDERWAY TO EARN
AND SAVE HARD CURRENCY IS CITED BELOW.

A) A PRESS CAMPAIGN HAS STARTED TO REDUCE COAL CONSUMPTION
SO THAT MORE WILL BE AVAILABLE FOR EXPORT.

B) THERE IS ALSO A CAMPAIGN IN THE PRESS AND THROUGH
THE GOVERNMENT BUREAUCRACY TO REDUCE CEMENT CONSUMPTION
AND STEEL-PRODUCT IMPORTS. THE OBJECTIVE APPEARS
TO BE TO MAKE CEMENT A MAJOR EXPORT AND TO REDUCE THE
NEARLY ONE BILLION DOLLARS THE ECONOMY IS SPENDING ANNUALLY
ON STEEL IMPORTS. THE INAUGURATION THIS YEAR OF SEVERAL
NEW STEEL AND CEMENT PLANTS SHOULD ASSIST IN THIS EFFORT.

C) THE GOVERNMENT HAS INSTITUTED SUGAR RATIONING RATHER
THAN CUT OFF SUGAR EXPORTS, AS WAS DONE TWO YEARS AGO WHEN
SUPPLIES WERE INADEQUATE TO MEET LOCAL DEMAND.

D) MEAT EXPORTS HAVE BEEN CONTINUED EVEN THROUGH THE
GOVERNMENT REPEATEDLY ADMITS THERE IS NOT ENOUGH MEAT TO
COVER DOMESTIC DEMAND AT CURRENT PRICES.

E) THE REGULATION OF LOCAL DOLLAR ACCOUNTS HAS BEEN
LIBERALIZED TO ATTRACT MORE HARD CURRENCY INTO THE
GOVERNMENT'S COFFERS.

F) FURNITURE EXPORTS TO THE WEST HAVE BEEN INCREASED
EVEN THOUGH THE DOMESTIC SUPPLY IS FALLING FURTHER
BEHIND DEMAND.

G) SHOE AND CLOTHING EXPORTS TO THE WEST HAVE BEEN
STEPPED UP EVEN THOUGH THE SUPPLY OF QUALITY
SHOES AND CLOTHING IS ARE SHORT OF LOCAL NEEDS.

12. IN ADDITION TO ENTICING MORE FINANCIAL CREDITS

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FROM RELUCTANT WESTERN BANKS AND BRINGING ITS TRADE BALANCE INTO SURPLUS, POLAND COULD OBTAIN FURTHER LARGE AMOUNTS OF HARD-CURRENCY ASSISTANCE THROUGH FORWARD SALES OF ITS COAL AND COPPER. UNDER SUCH SALES, WHICH AMOUNT TO A MORTGAGING OF PART OF POLAND'S FUTURE EXPORT EARNINGS, LARGE CREDITS ARE RECEIVED NOW AT COMMERCIAL INTEREST RATES, TO BE REPAYED BY FUTURE-YEAR SHIPMENTS OF COAL AT THE THEN WORLD MARKET PRICES. SUCH DEALS HAVE BEEN CONSUMMATED IN RECENT MONTHS WITH ITALY AND SPAIN FOR COAL AND THE FRG FOR COPPER. WE WOULD ESTIMATE THAT UPWARDS OF ONE BILLION DOLLARS OF NEW LOANS COULD BE SECURED IN THIS FASHION, ESPECIALLY IF POLAND SHOWED MORE WILLINGNESS TO FIX PRICES FOR FUTURE DELIVERIES OF THESE COMMODITIES.

13. EVEN THOUGH WESTERN BANKERS NOW TALK MUCH LESS CONFIDENTLY THAN THEY ONCE DID ABOUT THE SOVIETS BEING THE ULTIMATE GUARANTOR OF LOANS TO POLAND, SOME MINOR HELP MIGHT BE SECURED FROM THE EAST AS WELL. IT IS VERY UNLIKELY THAT THE SOVIETS WOULD PROVIDE POLAND DIRECTLY WITH SIGNIFICANT AMOUNTS OF THE HARD CURRENCY IT NEEDS. HOWEVER, IN VIEW OF JUNE 25 AND THEIR CONCERN THAT POLAND REMAIN QUIET, THE SOVIETS MIGHT MAKE A FEW MORE CONCESSIONS TO THE POLES DURING THEIR FREQUENT BILATERAL NEGOTIATIONS ON TRADE AND INVESTMENT MATTERS.

14. ANOTHER MEASURE WHICH COULD BRING POLAND INCREASED AMOUNTS OF WESTERN LOANS, EVEN OF THE FINANCIAL-CREDIT VARIETY, WOULD BE A WILLINGNESS TO PAY HIGHER INTEREST RATES. FOR SOME MONTHS, WESTERN BANKS HAVE BEEN TRYING UNSUCCESSFULLY TO CONVINCE POLAND TO PAY MORE THAN THE 1-1/2% OVER LIBOR WHICH IT IS NOW CHARGED FOR MOST WESTERN CREDITS. AS POLAND'S CREDIT STANDING HAS WEAKENED, THE BANKS HAVE BEEN RELUCTANT TO LEND TO POLAND AT RATES ONLY SLIGHTLY HIGHER THAN THEY CAN GET FROM MUCH MORE SOLVENT CLIENTS. IF POLAND WERE WILLING TO PAY INTEREST RATES 1-3/4% OR MORE OVER LIBOR, IT COULD PROBABLY GET CONSIDERABLY MORE HELP FROM WESTERN BANKS.

15. AN ADDITIONAL MOVE WHICH COULD ASSIST POLAND WITH ITS FINANCIAL PROBLEMS WOULD BE JOINING THE IMF. SUCH A STEP WOULD BE REASSURING TO WESTERN BANKERS AND WOULD

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SUPPLY SOME RELATIVELY QUICK, LOW-INTEREST FINANCIAL RESOURCES TO POLAND THROUGH QUICK DRAWDOWNS OF AT LEAST THE FIRST CREDIT TRANCE OF ITS FUND QUOTA. POLAND'S PREVIOUS REASONS FOR NOT JOINING THE IMF--UNWILLINGNESS TO COMPLY WITH THE FUND'S DATA-DISCLOSURE REQUIREMENTS AND REAL OR IMAGINED SOVIET OPPOSITION--MAY NO LONGER BE DETERMINING, NOW THAT THE COUNTRY HAS HAD TO PROVIDE

SUCH EXTENSIVE DATA TO GET NEW LOANS FROM PRIVATE BANKS AND THE SOVIETS CAN OFFER SUCH LIMITED HELP IN SOLVING POLAND'S FINANCIAL PROBLEMS.

16. CONCLUSIONS: EVEN IF THERE IS NO MARKED IMPROVEMENT IN ITS CRUCIALLY IMPORTANT HARD-CURRENCY TRADE BALANCE, POLAND HAS ENOUGH OPTIONS STILL AVAILABLE TO AVOID SEEKING DEBT RESCHEDULING FOR AT LEAST SIX MONTHS TO A YEAR. IF IMPROVING THE TRADE BALANCE PROVED TO BE POSSIBLE ONLY BY SUBJECTING DOMESTIC CONSUMPTION PATTERNS TO DRACONIAN MEASURES OF A POLITICALLY EXPLOSIVE NATURE, THE REGIME MIGHT DECIDE TO SEEK DEBT RESCHEDULING EARLIER THAN WOULD BE ABSOLUTELY NECESSARY RATHER THAN RUN THE GUANTLET DURING AN EXTENDED PERIOD OF HEIGHTENED CONSUMER DISCONTENT. THE LEADERSHIP MIGHT SETTLE FOR A SLOWER RATE OF TRADE-BALANCE IMPROVEMENT AND NEGOTIATE A RESCHEDULING OF WESTERN DEBT BEFORE IT WAS FORCED TO DO SO FROM A POSITION OF COMPLETE FINANCIAL PROSTRATION.

17. THE PACE OF ECONOMIC RECOVERY IN THE WEST WILL PLAY A VITAL ROLE IN POLAND'S TROUBLED FINANCIAL FUTURE. IF THE WESTERN ECONOMIES HEAT UP RAPIDLY, POLAND WILL FIND IT RELATIVELY EASY TO RESTORE ITS FAVORABLE HARD-CURRENCY TRADE BALANCE, BUT MAY HAVE ITS ACCESS TO WESTERN BANK CREDITS SHARPLY CURTAILED AS PRIME INDUSTRIAL BORROWERS IN THE WEST SOP UP MOST OF THE AVAILABLE CREDIT. IF, AS SEEMS MORE LIKELY, THE RECOVERY IN THE WEST IS GRADUAL AND HALTING, THE GRADE-BALANCE IMPROVEMENT WILL BE MUCH SLOWER, BUT THE BANKS WILL BE MORE WILLING TO MEET POLAND'S CREDIT NEEDS.

18. DESPITE THE IMPOSING DIMENSIONS OF POLAND'S DEBT, WESTERN BANKERS SHOULD HAVE NO FEARS OF AN OUTRIGHT CONFIDENTIAL

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DEFAULTH ON ANY OF POLAND'S DEBT, UNLESS THERE SHOULD BE A MAJOR DISRUPTION IN EAST-WEST RELATIONS. EVEN THOUGH A RESCHEDULING COULD RESULT IN A FIVE-YEAR LOAN BEING REPAID OVER EIGHT TO TEN YEARS, ADDITIONAL INTEREST WOULD BE COLLECTED FOR THE LOAN EXTENSION, PERHAPS AT AN EVEN HIGHER RATE. POLISH AUTHORITIES SEEM FULLY AWARE THAT RELIABLE BEHAVIOR AS A BORROWER IS VITAL IF THEY ARE TO CONTINUE THEIR INCREASED ECONOMIC INVOLVEMENT WITH THE WEST. MOREOVER, ONE OF THE FEW EXPLANATIONS FOR BELT-TIGHTENING WHICH MIGHT BE CONVINCING TO POLISH CONSUMERS OF ALL SOCIO-ECONOMIC LEVELS IS THAT SACRIFICES ARE REQUIRED TO PERMIT THE CONTINUANCE AND EXPANSION OF COMMERCIAL AND OTHER CONTACT WITH THE WEST.
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